FISCAL NOTE

Bill #: **HB0654**

Title: **Revise tax treatment of nondeductible self-employment taxes**

Primary Sponsor: **Trudi Schmidt**

Status: **As introduced/revised**

Sponsor signature Date

Dave Lewis, Budget Director Date

Fiscal Summary

	FY2000 Difference	FY2001 Difference
Expenditures:		
General Fund	$0	$0
Revenue:		
General Fund	$0	$4,000,000
Net Impact on General Fund Balance:	**$0**	**$4,000,000**

Yes	No		Yes	No	
	X	Significant Local Gov. Impact		X	Technical Concerns
	X	Included in the Executive Budget		X	Significant Long-Term Impacts

Fiscal Analysis

ASSUMPTIONS:

1. This proposal applies to tax years beginning after December 31, 1999 (tax year 2000).
2. The proposal clarifies that the current law itemized deduction for federal income taxes does not include any self-employment tax paid. This is current practice, and is noted on current individual income tax forms. Therefore, this part of the bill has no significant revenue impact.
3. The bill also provides that taxpayers will be able to deduct their federal *liability* for the tax year, rather than deduct the amount of federal tax *paid* in the tax year. This will have a significant *one-time* effect on revenues in FY2001.
4. Under current law, taxpayers who had tax year 1999 federal tax liability in excess of the amount withheld or paid through estimated tax payments for tax year 1999, would have claimed the excess liability as a prior year deduction in tax year 2000. Under this proposal, these taxpayers will not be allowed to claim this deduction in tax year 2000. Under the assumption that allowing a deduction for full tax liability will offset the deduction that would have occurred by adding current year withholding plus prior year

deductions, there is no impact in tax year 2000 for that group of taxpayers that systematically under withholds for federal income tax purposes.

5. Under current law, taxpayers who had a tax year 1999 federal tax liability that was less than the amount withheld or paid in estimated tax payments for tax year 1999, would be required to claim the federal income tax refund as income in tax year 2000. Under the proposal these taxpayers would still be required to claim the refund as income. However, taxpayers who systematically overwithhold for federal tax purposes will at the same time experience a reduction in the amount of federal taxes deducted for the current tax year. This will act to increase taxable income by the amount forecast to be claimed as federal income tax refunds in tax year 2000, or by $136.8 million.
6. The net effect of assumptions 4 and 5, *prior to any taxpayer behavioral changes*, is a decrease in itemized deductions of approximately $136.8 million for tax year 2000. At an average marginal tax rate of 6.5% for taxpayers who itemize income tax returns, this would result in an increase in general fund revenue of $8,891,000 for FY2001.
7. However, taxpayers and tax preparers, will have the opportunity to anticipate and plan for the adverse tax impacts inherent in this proposal. This prior tax planning will act to reduce the one-time revenue impact to $4,000,000 in FY2001.

FISCAL IMPACT:

	FY2000 Difference	FY2001 Difference
Revenues:		
General Fund (01)	$0	$4,000,000

LONG-RANGE IMPACTS:

There are no long-range impacts to revenue under this proposal. Under current law, the effect of allowing taxpayers to deduct their federal tax *paid* is balanced out over time by allowing an additional deduction the following year for any liability in excess of the amount paid, or by requiring federal income tax refunds to be reported as income, to the extent that they were previously used as a deduction. Under the proposal, there will be a one-time impact in FY2001, but after that all taxpayers will be automatically adjusted each year by deducting their full tax liability.